

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
B & C WELDING, INC. }.

For Appellant: Robert W. Hanrahan
Certified Public Accountant

For Respondent: Mark McEvilly
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of B & C Welding, Inc., against a proposed assessment of additional franchise tax in the amount of \$2,474 for the income year ended September 30, 1977. Subsequent to the filing of this appeal, appellant paid the proposed assessment in full. Accordingly, pursuant to section 26078 of the Revenue and Taxation Code, this appeal is treated as an appeal from the denial of a claim for refund.

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The issue presented is whether respondent properly disallowed certain bad debt deductions claimed by appellant for the income year in question.

Appellant, a California corporation formed in 1969, utilizes the accrual basis of accounting. In September of 1976, prior to the year at issue, Paul Stine (hereinafter "Stine") purchased one hundred percent of the capital stock of appellant from W. L. Carter (hereinafter "Carter"). Thereafter, Stine engaged an accountant to review appellant's financial records. The accountant determined that many accounts were delinquent but were still carried in accounts receivable as active accounts. Appellant contends that attempts were then made to collect all such delinquent accounts, but that they proved unsuccessful. Appellant then "wrote off" the following accounts and claimed them as bad debt deductions for the year at issue:

| <u>Debtor</u> | <u>Amount</u> |
|---------------------|---------------------------|
| Azzat Rassuli | \$16,339.82 |
| W. L. Carter | 7,372.26 |
| Faye Carter | 365.00 |
| (per Sales Journal) | 1,063.97 |
| Dec. 1976 Journal | 886.00 |
| Year End Additional | 1,451.95 |
| Total | <u><u>\$27,479.00</u></u> |

Respondent disallowed the bad debt deductions, contending that appellant failed to prove that such debts became worthless in the year claimed. Denial of appellant's protest led to this appeal.

Section 24348 of the Revenue and Taxation Code permits the deduction of "debts which become worthless within the income year." However, the burden is upon the taxpayer to establish by objective standards that the debt for which a deduction is claimed had value at the beginning of the year of deduction, and that the debt became worthless within the year of deduction. (Appeal of Alvest Investment Company, Inc., Cal. St. Bd. of Equal., Aug. 16, 1977; Appeal of Jordan Associates, Inc., Cal. St. Bd. of Equal., April 24, 1967; Appeal of Kuhn Enterprises, Inc., Cal. St. Bd. of Equal., Aug. 3, 1965.) **That is, a bad debt deduction may not be allowed for a particular year if the debt became worthless in a prior year.** (Appeal of Real Estate Buy Keller, Cal. St. Bd. of Equal., Nov. 13, 1973.) The time for worthlessness must

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be fixed by an identifiable event or events in the year in which the deduction is claimed which furnish a reasonable basis for abandoning any hope of future recovery. (Appeal of Parabam, Inc., Cal. St. Bd. of Equal., June. 29, 1982.) Moreover, mere nonpayment of a debt does not prove its-worthlessness, and a-deduction is not justified when the creditor fails to take reasonable steps to enforce collection unless there is proof that those steps would be futile. (Appeal of Jordan Associates, Inc., supra.)

On July 31, 1974, under the direction of Carter, its previous owner, appellant made a loan to **Azzat** Rassuli. While the details of this transaction are unclear, it appears that Rassuli agreed to repay the loan in one year. However, he was unable to repay at that time, and Carter authorized a six month extension. At that time, approximately January of 1976, Carter and the then-prospective purchaser of appellant, Stine, learned that Rassuli had left the country owing several people money and now resided in Israel. All attempts to contact Rassuli failed. As indicated above, after appellant was purchased by Stine in September of 1976, the decision was made to claim this account as a bad debt deduction for the income year ended September 30, 1977.

However, based upon the record before us, it appears that the facts upon which appellant bases its claim of worthlessness of the Rassuli account occurred prior to the year at issue. Rassuli left the United States in January of 1976. Attempts to contact him made by Carter and Stine failed at that time. Appellant has not established any "identifiable event" that occurred in the year at issue which would furnish a reasonable basis for abandoning any hope of future recovery. Accordingly, **we must** find that appellant has not proved that the Rassuli account became worthless in the year at issue.

Moreover, there is no evidence in the record that would indicate that any "identifiable events" occurred in the year at issue which established the worthlessness of any of the five other accounts. In addition, there is no evidence that appellant took steps to enforce the collection of any of these accounts during the year at issue.

Accordingly, for the foregoing reasons, we must sustain respondent's action.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section **26077** of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of B & C Welding, Inc., for **refund** of franchise tax in the amount of \$2,474 for the income year ended September 30, 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of October , 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett _____, Chairman
Conway H. Collis _____, Member
Ernest J. Dronenburg, Jr. _____, Member
Richard Nevins _____, Member
Walter Harvey* _____, Member

*For Kenneth Cory, per Government Code section 7.9